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FISCAL IMPACT STATEMENT

LS 6704 **NOTE PREPARED:** Feb 24, 2007
BILL NUMBER: HB 1461 **BILL AMENDED:** Feb 23, 2007

SUBJECT: Tax Exemptions and Credits..

FIRST AUTHOR: Rep. Bosma **BILL STATUS:** 2nd Reading - 1st House
FIRST SPONSOR:

FUNDS AFFECTED: X **GENERAL** **IMPACT:** State & Local
X **DEDICATED**
FEDERAL

Summary of Legislation: (Amended) *Tax Exemption for Patent-Derived Income:* The bill exempts from taxation certain income derived from qualified patents and earned by a taxpayer that is domiciled in Indiana and considered a small entity by the United States Patent and Trademark Office. The bill defines qualified patent to include only utility patents and plant patents. The bill provides that the total amount of exemptions claimed by a taxpayer in a taxable year may not exceed $5,000,000. It provides that a taxpayer may not claim an exemption for income derived from a particular patent for more than ten years. It also provides that the exemption for the income from a particular qualified patent begins to phase-out starting with the sixth taxable year in which the exemption is claimed for the patent.

Alternative Fuel Vehicle Manufacturer Tax Credit: The bill establishes the Hoosier Alternative Fuel Vehicle Manufacturer Tax Credit. It provides that the Indiana Economic Development Corporation (IEDC) may award such a tax credit to businesses that make certain qualified investments in Indiana for the manufacture or assembly of alternative fuel vehicles. It also provides that the IEDC determines the percentage of the tax credit, which may not exceed 15%.

Effective Date: (Amended) January 1, 2007 (retroactive); January 1, 2008.

Explanation of State Expenditures: (Revised) *Indiana Economic Development Corporation (IEDC):* The bill will require the IEDC to accept and review applications for the Alternative Fuel Vehicle Manufacturer Tax Credit, and make determinations as to tax credit awards. The bill requires the IEDC to enter into an agreement with tax credit recipients specifying project information and operational information relating to the manufacturing or assembly facilities constructed. The funds and resources required to implement this tax credit program could be supplied through a variety of sources, including the following: (1) existing staff and resources not currently being used to capacity; (2) existing staff and resources currently being used in another program; (3) authorized, but vacant, staff positions, including those positions that would need to be reclassified; (4) funds that, otherwise, would be reverted; or (5) new appropriations. Ultimately, the source of funds and resources required to satisfy the requirements of this bill will depend upon legislative and administrative actions. The February 19, 2007, state vacant position report indicates that the IEDC has 33 vacant full-time positions.

Department of State Revenue (DOR): The DOR will incur additional expenses to revise tax forms, instructions, and computer programs to reflect the new exemption for patent-derived income and the tax credit for investment in alternative fuel vehicle manufacturing. Under the tax credit, the DOR may have to make assessments against taxpayers that do not comply with the requirements of the agreement they execute with the IEDC to receive the tax credit. The DOR's current level of resources should be sufficient to implement these new responsibilities.

Explanation of State Revenues: (Revised) *Tax Exemption for Patent-Derived Income:* The bill would reduce state Adjusted Gross Income (AGI) Tax or Financial Institutions Tax liabilities of taxpayers that derive income from utility patents or plant patents issued after December 31, 2007. The potential revenue loss to the state from this exemption is indeterminable and could begin in FY 2009. The maximum exemption a taxpayer may claim in a taxable year is $5 M The maximum exemption amount translates into a $170,000 reduction in tax liability for an individual taxpayer, and a $425,000 reduction in tax liability for a corporate taxpayer or financial institution. Thus, if 10 taxpayers qualify for the maximum exemption amount each year, the annual revenue loss could range from $1.7 M (if all the taxpayers are individuals) to $4.25 M (if all the taxpayers are corporations). The exemption is phased-out once a taxpayer has claimed the exemption for five years, with the exemption reduced by 10% per year after the fifth year it is claimed.

Alternative Fuel Vehicle Manufacturer Tax Credit: The bill would reduce state AGI Tax, Financial Institutions Tax, or Insurance Premiums Tax liabilities of taxpayers that make qualified investment in infrastructure, facilities, machinery, and equipment in Indiana to manufacture or assemble alternative fuel vehicles. The bill defines an "alternative fuel vehicle" as a vehicle designed to operate on at least one of the following fuels: methanol, denatured ethanol, and other alcohols; mixtures containing 85% methanol, denatured ethanol, and other alcohols with gasoline or other fuel; natural gas; liquefied petroleum gas; hydrogen; coal-derived liquid fuels; non-alcohol fuels derived from biological material; P-Series; electricity; or electric battery and diesel. The bill requires the tax credit to be determined by the Indiana Economic Development Corporation (IEDC), but prohibits the tax credit from exceeding 15% of the investment made in Indiana by the taxpayer in the taxable year. The IEDC may award credits for investment made between 2007 and 2012, but tax credits awarded during this period may be carried over to years after 2012. The potential revenue loss to the state from this exemption is indeterminable and could begin as early as FY 2008, if tax credits are awarded during 2007.

Background: Tax Exemption for Patent-Derived Income: The bill establishes an exemption from the AGI Tax and the Financial Institutions Tax for certain income derived in the taxable year from utility patents and plant patents issued to "qualified taxpayers" after December 31, 2007. The aggregate amount of patent-related income a taxpayer may exempt in a taxable year is $5 M and a taxpayer may claim the exemption for ten years with respect to a particular patent. The exemption is phased-out for a taxpayer after it is claimed for five years with respect to a particular patent. The taxpayer is able to exempt 100% of the patent-derived income up to $5 M in the first five years. This percentage declines by 10% per year after the fifth year - from 80% in the sixth year to 10% in the tenth year.

Since 1995, an average of about 1,500 patents of all types (utility, plant, design, and other patents) have been granted annually to persons or entities in Indiana. However, annual patent totals for Indiana persons or entities have declined in recent years from a high of 1,745 in 2002 to 1,246 in 2005. The annual patent total is attributable primarily to utility patents, with utility patents granted averaging about 1,300 per year since 1995. The annual total for utility patents granted to Indiana persons or entities also has declined from a high of 1,439 in 1999 to 1,108 in 2005. A ***utility patent*** may be granted to anyone who invents or discovers any new, useful, and nonobvious process, machine, article of manufacture, or composition of matter, or any new and useful improvement thereof. Data is unavailable as to annual total plant patents granted to Indiana persons or entities, however, it appears it does not exceed 100-200 per year based on the above-described averages. A ***plant patent*** may be granted to anyone who invents or discovers and asexually reproduces any distinct and new variety of plant. In addition, data is unavailable describing the typical income generated by patents granted to persons or entities in Indiana. The patent-derived income that would be exempt under the bill is: (1) licensing fees or other income received for the use of a patent; (2) royalties received for the infringement of a patent; and (3) receipts from the sale of a patent. The bill defines a "qualified taxpayer" as a taxpayer that is:

(1) Considered a small entity by the U.S. Patent and Trademark Office, defined as an independent inventor, small business concern, or nonprofit organization eligible for reduced patent fees.
(2) Domiciled in Indiana.

Since the exemption is effective beginning in tax year 2008, the fiscal impact would begin in FY 2009. Revenue from the corporate AGI Tax and the Financial Institutions Tax is deposited in the state General Fund. The revenue from the AGI Tax on individuals is deposited in the state General Fund (86%) and the Property Tax Replacement Fund (14%).

Background: Alternative Fuel Vehicle Manufacturer Tax Credit: The bill establishes a nonrefundable tax credit against the AGI Tax, Financial Institutions Tax, or Insurance Premiums Tax for individual and corporate taxpayers for investment in alternative fuel vehicle production or assembly facilities. The credit is equal to a maximum of 15% of the investment made in Indiana in a taxable year. The credit is nonrefundable, and may not be carried back. Excess tax credits may be carried forward for up to nine years following the year in which the taxpayer makes the investment.

To obtain the tax credit, a taxpayer must apply to the IEDC before making the investment. Upon determination by the IEDC that the proposed investment satisfies the tax credit requirements, it must enter into an agreement with the taxpayer. The agreement must include:

(1) A description of the project.
(2) The first year the credit will be claimed.
(3) The amount of tax credit allowed each year.
(4) A requirement that the taxpayer must maintain operations at the project site for the 10 years the credit is available.
(5) Employment and payroll requirements at the project site.

If the IEDC determines that the taxpayer is not complying with the requirements of the tax credit agreement, the Department of Revenue must make an assessment against the taxpayer which may not exceed the total tax credits allowed the taxpayer. The bill also prohibits a taxpayer (including pass through entities and shareholders, partners, or members of pass through entities) from receiving the tax credit if the taxpayer receives one of the following tax credits for the same project.

(1) Enterprise Zone Investment Cost Credit.
(2) Industrial Recovery (Dinosaur) Tax Credit.
(3) Military Base Recovery Tax Credit.
(4) Military Base Investment Cost Credit.
(5) Capital Investment Tax Credit.
(6) Community Revitalization Enhancement District (CRED) Tax Credit.
(7) Venture Capital Investment Tax Credit.
(8) Hoosier Business Investment Tax Credit.

Explanation of Local Expenditures:

Explanation of Local Revenues: *Tax Exemption for Patent-Derived Income:* Because the exemption for individuals receiving patent-related income would decrease taxable income, counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) may, as a result, experience an indeterminable decrease in revenue from these taxes.

State Agencies Affected: Department of State Revenue; Indiana Economic Development Corporation.

Local Agencies Affected: Counties with a local option income tax.

Information Sources: *Patents by Country, State and Year - All Patent Types (December, 2005)*, U.S. Patent and Trademark Office, Electronic Information Products Division, Patent Technology Monitoring Branch, http://www.uspto.gov/web/offices/ac/ido/oeip/taf/cst_all.htm.

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